RENT AND PROFIT.

Not a little of the confusion in recent economic literature would seem to be due to the attempt to force the new wine of more modern concepts into the old bottles of Ricardian dicta. This is nowhere more evident than in the varied and conflicting duties which of late we have imposed upon the term "rent."

To the Ricardian school of economics the price of every product contained two elements, "cost" and "rent." By the former, they understood the cost at the margin of production; by the latter, the surplus obtained by those enjoying special advantages in the production of any commodity—the differential surplus—as it is sometimes called. They also held, that while the first enters into the determination of price, the second is a surplus that is determined by price.

To these two concepts recent literature has added a third, namely, a surplus which does enter into the determination of price; or, as it is usually stated, "there is a marginal surplus."

Some foreshadowing of this new concept may be found as early as 1829. And yet not a little confusion may still be found in the writings of its strongest advocates, due to the fact that they continue to include both the "price-determined" and the "price-determining surplus," under the one term "rent."

The old contention, that cost determines exchange value, seems to involve the assumption that there is no surplus at the margin of production; or, as it is sometimes stated, "there is always some no-rent land." This assumption, however, was not accepted without protest, even by the adherents of the Ricardian school.

J. S. Mill files exceptions to it, all through chapters 4, 5 and 6, Book III, and in the latter sums up as follows: "Rent

is not an element in the cost of production of the commodity which yields it, except in the case (rather conceivable than actually existing) in which it results from and represents a scarcity value. But when land capable of yielding rent in agriculture is applied to some other purpose, the rent which it would have yielded is an element in the cost of production of the commodity which it is employed to produce." It is manifest that we have here a recognition of the "marginal" or "price-determining surplus." *

Professor S. N. Patten, in his "Premises of Political Economy," gives us possibly the fullest statement of this phase of the question, and holds that the contention of a no-rent land fails on five different counts: "First, to obtain uncultivated land for tillage, farmers must compete with those who can afford to pay rent for uncultivated land by using it for pasture, for wood and many similar purposes. For this reason the poorest land in cultivation must pay rent, since if the farmers will not pay rent, the landlords would let it to herders and others who could afford to give much for the use of uncultivated land."

It will hardly be necessary to follow Professor Patten through his other four counts; the fundamental thought running through these, as through all the protests against the contention of a no-rent land, is in simple, as follows: If certain lands or farms, however much they vary among themselves in fertility and distance from market, are yet all of them distinctly superior to all other lands for the production of a certain brand of wine, and the supply of such land is relatively limited, two forms of surplus may arise. The variations in fertility and distance from market, within the the group, will give rise to a "price-determined surplus"—the old Ricardian rent. So long as all this land is specially efficient in the growing of this wine, and the supply of this

* The German literature on this point is quite interesting, especially Nebenius, 1829, and Herman, 1832. For a fuller treatment, see the writer's "History of the General Doctrine of Rent in German Economics."

land remains relatively limited, the marginal land, in common with all other land, will be able to secure an additional surplus, due to scarcity. This last surplus is enjoyed by the marginal producer in common with every other member of the group, and enters into the determination of the price of the commodity produced by the group.

Let us now return to the above quoted passage from Mill. In this it is clear that Mill approached this question from the standpoint of the Ricardian theory—value is determined by cost. He therefore regarded scarcity value, and hence the surplus due to scarcity as of rare occurrence. Professor Patten, on the other hand, urges that Ricardo himself had made serious breaches in this theory of value. "He was compelled to make so many exceptions to it that its utility in explaining the relation of value to cost was much reduced. . . . . In fact, when money, the products of land and of international trade are excluded from the operation of the general law of value, in a modern nation there does not remain much of the general law to follow. Scarcity has become almost as important and universal an element in value as has the quantity of labor." *

But whether we agree with Mill or with Patten, it still remains true that both forms of surplus may and do arise. Again, since the "surplus due to scarcity" enters into the determination of price, it stands in direct antithesis to the older form of surplus, which does not determine, but is determined by price. Hence, confusion will result, if, without any further attempt to distinguish between them, we continue to speak of both forms of surplus as "rent."

These two forms of surplus might be called, as they sometimes are, the "differential" and "marginal surplus;" or the first might be called the "individual" and the second the "group surplus;" or we might call the first a "price-determined" and the second a "price-determining surplus."

* "The Theory of Dynamic Economics," page 30.

In other words the first might be variously characterized as a

DIFFERENTIAL,
INDIVIDUAL
or
PRICE-DETERMINED } SURPLUS.

while in the second we have a

MARGINAL,
GROUP
or
PRICE-DETERMINING } SURPLUS.

The question now arises: Which of these terms brings out in the clearest manner the essential economic difference between these two forms of surplus? We can only answer, that since the first inception of the doctrine of rent, the "price-determined" element of the concept has been recognized as the fundamental condition of "rent." Hence, though the last pair of terms are cumbersome, we will have recourse to them throughout the present discussion, because they keep before the mind the fundamental antithesis between these two forms of surplus; one "price-determined" and the other "price-determining." As the argument proceeds, it will be seen that the use of other terms, like "marginal" and "differential surplus," has resulted in some confusion, for the reason that they do not keep this fundamental distinction ever before the mind. Again some writers, while recognizing this distinction in connection with the entrepreneur's surplus, are not so clear when they come to discuss the surplus from land.

Professor Commons, in his "Distribution of Wealth," mars the usefulness of an otherwise excellent book, in this way. In his discussion of the entrepreneur's profit, he endeavors to maintain this distinction, speaking of the first form of surplus as "personal or temporary profits," and of the second as "permanent or monopoly profits." How

apt these terms are we will not here stop to inquire; they have, however, this merit; they are a conscious endeavor, to preserve the distinction between these two forms of surplus, in our terminology. But it can, we think, be shown, that he has not been so careful in his discussion of the surplus from land. To that end let us inquire as to his use of the term "rent."

First, note that this writer follows President Walker, calling the surplus from land—rent, and the surplus of the entrepreneur—profit. Again, he subdivides the latter; his "personal" or "temporary profits" being identical with our "price-determined surplus," while his "permanent" or "monopoly" profits are identical with our "price-determining surplus." With this in mind let us turn to page 229, where he writes, "A continually growing surplus falling to the owners of monopoly privileges, which becomes petrified in the form of *rent* and *permanent* or *monopoly profits*." It is, I think, fair to assume, that he here means by "rent:" that surplus from land which is the same in kind as the "permanent or monopoly profits" of the entrepreneur. In other words, he is speaking of the "price-determining surplus" from land as the "rent" of land.

On the other hand he says, page 203: "If adjoining land is better, it will pay more rent; if poorer, less rent." That he is here speaking of the "price-determined surplus,"—the old Ricardian rent—need hardly be urged. Or, he applies the term "rent," to both forms of the surplus from land, without any attempt, so far at least as the context of these passages is concerned, to distinguish between them. Nor can he plead ignorance of the existence of the two forms of surplus; on the contrary, he quotes quite freely from Professor Patten in support of the contention, that there is a surplus which enters into the determination of price. Again, in his discussion of the entrepreneur's return, he endeavors to preserve the distinction between the two forms of surplus by giving them separate names.

In one instance at least, he has endeavored to find separate names for the two forms of surplus from land. On page 221, he says: "As soon as land is cultivated at all successfully, it yields a *permanent rent*, and this, if it be the poorest land in use for the production of the commodity in question, becomes a permanent part of the expenses of production of that commodity. The *superior rents* paid out of the same commodity where it is produced on superior land, are again an additional surplus growing out of the superior advantages of such lands, and are only partly to be considered as expenses of production."

Here corresponding to his "permanent or monopoly profits," we have "permanent rent;" while for "personal or temporary profits," we have "superior rent." If he had called the last "temporary rent," it would have the merit of being coherent with his terminology of profit, no matter how faulty that may be. Instead, he preserves this terminology in one case, only to depart from it in the other. That this lack of persistency or consistency in terminology will prove confusing to the average reader, need hardly be urged.

In the *Quarterly Journal of Economics*,* J. A. Hobson writes: "Now these limitations to the statement that rent does not form an element in price amount to the admission that the rule only applies where the margin of employment stands at no-rent, and this is only the case in unqualified agricultural land. Wherever the worst land in cultivation for a special purpose draws a rent, that rent figures in prices."

Notice that we have here, nothing by which we can distinguish between the "price-determined" and price-determining surplus;" the term "rent" being used indifferently for either of them. On page 275, however, he says: "It will be open to us, if we prefer it—for it is entirely a question of convenience in the use of terms—to say that land, ... at the margin of employment, pays no rent,

* April, 1891, p. 275.

that is, we may take the lowest return for the use of land, and call it by some other name than rent. We would thus be able to maintain as a general proposition, that rent forms no element of price. But to do this, we would be compelled to an elaborate grading of industries, according to the prices paid for land, labor and capital, at the margin of employment in each respective industry.

"If, on the other hand, as seems more reasonable, we should prefer to measure by a single line of fixed money value applied through the whole of industry, we must call by the name rent all payments for the use of land, and all payments beyond three per cent and five shillings for the use of capital and labor. But whichever mode of reckoning we prefer will be equally applicable to all three requisites of production."

Now it may be true that "it is entirely a question of convenience in the use of terms," whether we employ separate and distinct terms for these two forms of surplus, or take "rent" as a general term applicable to both; and then distinguish between them by employing additional qualifying terms, "price-determined rent," and "price-determining rent." But it is hardly a question of mere convenience, whether or not the fundamental cleavage plane in all questions of distribution shall be recognized in our terminology. In other words, we can only confound confusion by including both forms of surplus under a common name.

And yet upon this point the very elect themselves, in the person of Professor Clark, are betrayed into confusion. In the same number of the *Quarterly Journal of Economics* (p. 313), he writes: "There is another element in the composite returns of employes that is profit in an accurate sense of the term. It results from an unbalanced condition of industrial groups. Conditions are continually appearing in which too little is produced of certain commodities to meet the normal demand for them, and in which they sell for more than enough to pay interest on pure capital and wages

on all the working energy employed in producing them. Included in this total interest will be the rent of any land that may be in use in these industries, and included in wages will be the rewards of manager's time and effort. Above all these claims, the selling price of the goods may afford a residuum of pure profit. A discovery that should make the production of aluminium cheap would afford a profit on the making of it until this industry should become so much enlarged as to put upon the market as much of this metal as, under the new conditions, would be normal. After the discovery the competition of different producers would enlarge the production of this metal till the point would be reached at which it would not be profitable to move labor and capital from other working groups to this one. At this point the return of the industry would be theoretically absorbed in wages and interest. *In a balance condition of industries superior managers will earn more than others, and superior workers of every kind will do the same; but that gain which results from the distinctively dynamic cause, the discovery or change which throws production temporarily out of balance, ceases to exist. Such a condition of universal equilibrium is never practically reached, and at many points in the industrial system—not for any length of time the same points—pure profit is always to be found. This changeful element of gain is the one part of the actual social income not governed by the law of rent.*"

We have here a recognition not only of the differential gain or surplus, but also a recognition of the "group," "marginal" or "price-determining surplus;" the surplus due to an unbalanced condition of industries or to scarcity value; "the one part of the actual social income not governed by the law of rent." Professor Clark, indeed, carries this recognition of these two forms of surplus so far as to call one "rent" and the other "pure profit;" yet elsewhere in this same article, he is betrayed into including both forms of surplus under the common term "rent;" this resulting in

such verbal contradictions as cannot fail to confuse the general reader.

On page 304 he writes: "The differential gain of labor alone applied to fertile land is the more useful type of true rent." While on page 307 he writes: "The earnings of land are a sort of mock rent. They are equal to a differential product, but are not the genuine thing." To say of one and the same thing that it is the more useful type of *true rent*, and again, that it is a sort of *mock rent*, would certainly seem to involve a contradiction.

In seeking for the cause of this at least seeming contradiction, it should be noted, that while Professor Clark refers more than once to the Ricardian law of rent, he nowhere gives statement to the essential condition that it is a "price-determined surplus." Throughout the entire discussion, he seems to regard the differential aspect of this surplus as its essential condition. To his mind, if it is a differential gain it is a rent; if a true differential gain it is a true rent.

Now this may be true, but we take it that not a little confusion would have been avoided if he had thrown the accent not upon the differential, but upon the "price-determined" aspect of this gain. It would then have appeared, that what he is pleased to call the rent of land, really includes both the "price-determined" and "price-determining surplus." This, despite the fact that he had agreed to call the former "rent" and the latter "pure profit," and had said of this latter, "it is the one part of the actual social income not governed by the law of rent." That Professor Clark does include both forms of surplus under his "rent of land," we will now endeavor to show. On page 308 he says: "In any limited section of the general field of labor, wages must conform to a standard that is set in and for that field. . . What determines that level? What fixes general wages? The law in the case is that he gets what he is worth to society. If natural tendencies could have their way, the final man would get as a wage what he actually produces.

It is the productivity of labor that fixes its pay. . . . Such a condition of universal equilibrium is never reached."

In other words, the productivity of labor in some parts of the general field is greater than in other parts. The rate of wages, however, is set by the efficiency of labor in the least productive part of the general field. Hence in any part, as in agriculture, in which the productivity of labor is greater, there will accrue to the employer of labor, and later to the owner of land, a surplus equal to the difference between the productivity of labor in this special branch of industry, and its productivity in that branch in which it is least productive, since the rate of wages is set by the latter.

This surplus, however, is manifestly due to an unbalanced condition of industries; to a condition in which labor and capital will tend to move from other industries into agriculture; and so, according to Professor Clark, "is the one part of the actual social income not governed by the law of rent." Again, it is received by all owners of land, and is thus a "group," "marginal" or "price-determining surplus," which all receive in addition to any "price-determined surplus" that may accrue to some individuals within the group.

"It is now clear," says Professor Clark (page 310), "that in the strict sense of terms the *rent of land is not a differential product*. The surplus product of the earlier increments of labor applied to agricultural land are amounts remaining in the farmer's hands after wages are paid. . . . The pay of the farmer's men conforms directly to the rate that prevails in the general labor market, and the data for calculating the landlord's claim are therefore the product of the farm and the general rate of wages. If, however, land were the only instrument in use, the case would be different. . . There would be no industry outside of the agricultural limit, and the product of the last increment of work applied to the soil would constitute the standard of wages. The land in this case would yield a true differential product,

since the rent of it would consist of the sum of the difference between the product of the earlier increments of labor and the product of the last one.''

When Professor Clark declares that ''the differential gain of labor alone applied to fertile land is the more useful type of true rent,'' he has in mind the ''price-determined surplus,'' the old Ricardian rent. When, however, he says that ''the earnings of land are a sort of mock rent,'' he is thinking of a total which includes both the ''price-determined'' and ''price-determining'' forms of surplus, and thus concludes, that '' in the strict sense of terms the rent of land is not a true differential gain.'' It may fittingly be asked, why should the rent of land be made to include both forms of surplus; Professor Clark having declared that the latter form is ''the one part of the actual social income not governed by the law of rent."

Professor Clark, as we have seen, not only recognizes the difference between these two forms of surplus, but seeks to fix this in our literature, by giving them separate names, calling one ''rent,'' and the other ''pure profit,'' declaring of this last that ''it is the one part of the actual social income not governed by the law of rent.'' And yet, despite all this, he is betrayed into including both forms of surplus under rent of land. To us there seems to be but one explanation of this confusion, in the work of one whose name has become synonymous with our concept of a most clear and able thinker, and that is, that in his thinking on this question, he has thrown the accent upon the differential, rather than upon the ''price-determined'' aspect of rent.

While it is undoubtedly true that both forms of surplus may and do arise, yet by what compulsion must both of them be called ''rent?" This term has already been appropriated and clearly defined as a surplus which is determined by price. Why then should we surrender this use of it; that it may be re-appropriated and re-defined as any surplus above

cost? We have, in simple, a new concept, a "price-determining surplus," a concept which is diametrically opposed to the Ricardian concept of "rent." The two concepts have nothing in common, but the fact that they are both surpluses above cost. What then have we to gain by including both under the common term "rent?" The application of this term to the "price-determined surplus" has been fixed by usage, through several generations of economic writers. It would therefore seem wiser to confine the term "rent" to this concept, and seek for some other term for the newer concept of a "price-determining surplus."

This would mean, of course, that wherever we found a "price-determined surplus," whether from land or from the ability of the entrepreneur, we should call it a "rent" of that factor. In other words, if, as President Walker has shown, "the entrepreneur secures a surplus which follows the law of rent," we should call it the "rent" of the entrepreneur. Here we meet with the difficulty, that President Walker, while showing that the entrepreneur receives a surplus which follows the law of "rent," yet calls this the "profit" of the entrepreneur. This is open to the serious objection, that, no matter how confused economists may have been in the use of the word "profit," they seldom failed to hold that it enters into the determination of price, and thus is in direct antithesis to that which is determined by price.

Ricardo, in a foot-note, page 39, of his "Political Economy," writes: "Mr. Malthus appears to think that it is a part of my doctrine that the cost and value of a thing should be the same; it is, if he means by cost 'cost of production,' including profits." Again, on page 45, he writes: "The laws which regulate the progress of rent are widely different from those which regulate the progress of profits, and seldom operate in the same direction. While Mill writes: "Profits therefore as well as wages enter into the cost of production which determines the value of the produce." Again, President Walker, in his criticism of J. A. Hobson in a later

number of the *Quarterly Journal of Economics*, never fails to bring the discussion back to the fundamental concept, that "the essential fact in regard to rent is that it does not enter into cost of production."

This being the final test in regard to "rent," why not call that part of the entrepreneur's return which satisfies this condition the "rent" of the entrepreneur. In doing so we not only secure a short and convenient name, "rent," for that surplus which is determined by price, but we release another term, "profit," which we might be able to utilize in connection with our "price-determining surplus."

We would again repeat, that no matter how confused economists may have been in the use of the term "profit," they seldom failed to hold that profits entered into the determination of price. Hence the appropriation of this term "profit," to characterize the "price-determining surplus," would agree with the traditional use of this word in economic literature, at least so far as this fundamental cleavage plane is concerned.

On the other hand it must be admitted that the use suggested by President Walker is more in keeping with ordinary practice, and has now become incorporated in some measure into our literature. We would also willingly grant, that it is less important just what terms shall be adopted, than that there should be an agreement upon some terms that will avoid the confounding of the two forms of surplus.

Whether these two forms of surplus can be said to arise, in the case of the other factors in production, is too large a question to be included within the limits of this paper. But before there can be any extension of the terms "rent" and "profit" to these factors, it must first be shown that they, like land and entrepreneur, give rise to a "price-determined" and "price-determining surplus."

It is not given to any one person to say what terms shall be adopted. This can only result from the establishing of some concensus in the matter among economists generally. A single writer may show, as we have endeavored to do,

that a new concept has arisen, and that the failure to reach any agreement as to the terms employed, has resulted in growing confusion; he may then, as we have done, suggest such terms or use of terms as seem to him to avoid this confusion.

Again, too much must not be expected from these or any other equally short terms. If consciously or unconsciously, we think of these as meaning "differential" and "marginal surplus;" or "individual" and "group surplus;" or in fact anything but "price-determined" and "price-determining surplus," we are likely sooner or later to end in confusion. This is the fundamental difference between these two forms of surplus, which must ever be borne in mind.

When we write "rent," we should think "price-determined surplus;" and when on the other hand we write "profit," it is "price-determining surplus" that should be called up in our minds. If it is thought wiser to look for other terms than those here suggested, we can only urge that they should be such as will not cause us to lose sight of this, the real economic difference between these two forms of surplus.

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